

Persons who provide satellite television services, including basic network channels, premium channels, pay per view movies, sporting events, etc., are generally not subject to the Telecommunications Excise Tax liability. See 35 ILCS 630/1 et. seq. (This is a GIL).

January 4, 2002

Dear Xxxxx:

This letter is in response to your letter received by our office on September 5, 2001. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

We are seeking written advice as to your state's sales and use, telecommunications and/or other gross receipts tax treatment on the sales of personal television services by our client to subscribers located in your state. The relevant facts of our client's operations are discussed below:

STATEMENT OF FACTS

Overview

Our clients are planning to offer personal television services to subscribers located in your state. Our client's personal television service will allow viewers to do the following:

1. Automatically record television shows and watch them at a later time.
2. Pause or record live television broadcasts.
3. Create personalized programming based upon the viewer's previous viewing patterns.
4. Receive special data and video content.

In order for a subscriber to obtain our client's personal television service, a subscriber must purchase or have access to the following:

1. A Personal Video Recorder ('PVR') or Direct-to-Home Satellite Television Combo Box ('DSCB'), purchased from an unrelated third party retailer.
2. Television service via cable, satellite, or antennae.
3. A telephone line connected to the PVR's built-in modem or DSCB modem.

4. A current paid subscription to our client's personal television service.

Operational Aspects

In order for a subscriber to subscribe to our client's personal television service, the subscriber must first purchase a PVR or DSCB. PVRs and DSCBs are available for purchase through unrelated third party retailers and consist of a set-top unit and remote control. It is our understanding that sales tax on the units is collected by retailers at the point of sale, where applicable. The manufacture and sale of PVRs and DSCBs have been licensed to independent third-party consumer electronics manufacturers. Please note, Direct-to-Home Satellite Combo Boxes have the same capabilities as PVRs, but are integrated to allow the viewer to use our client's personal television service as well as receive direct-to-home satellite television programming. In all other aspects, PVRs and DSCBs are generally the same. Henceforth, both types of units will be referred to as PVRs.

PVRs come equipped with certain basic 'out-of-the-box' features. The basic features of PVRs are similar to video cassette recorders ('VCRs') in nature except that they permit VCR-like recording capabilities onto built-in hard drive as opposed to recording onto videocassettes. PVRs also provide viewers with several basic capabilities including: pause, rewind and fast forward navigation of live or recorded television and the ability to record selected programs by manually programming the PVR. PVRs have the capability to receive cable, satellite, and off-air television programming. **These capabilities exist independently of the personal television service provided by our client.**

As noted above, our client will offer enhancements to the inherent PVR capabilities to customers interested in subscribing to our client's personal television service. However, customers purchasing PVR hardware are not obligated to subscribe to our client's service. Essentially, a customer could purchase PVR hardware and connect it to their television source without activating our client's programming and still receive a basic form of functionality from the PVR hardware. In order for a subscriber to receive our client's services, the subscriber must pay a subscription fee directly to our client. The subscription fee is separate and distinct from the original purchase of the PVR from the unrelated third party retailer and is separately billed and collected by our client. This fee is distinct from any fee paid for cable or direct-to-home satellite television programming services.

Subscribers may subscribe to our client's personal television service in one of three subscription methods: (1) lifetime subscriptions (i.e. a one-time payment); (2) annual subscriptions (i.e. an annual payment); or (3) monthly subscriptions (i.e. a monthly payment).

In consideration of the subscription fees, our client will provide the following services:

1. Program Guides -- The program guides are delivered electronically on a nightly basis and stored on the hard drive of the subscriber's PVR. The Programming Guide contains approximately two weeks of television programming schedules and allows the customer to identify and schedule future recordings. The Programming Guide also contains program information that allows the subscriber to rate programs (using a 'thumbs up' or 'thumbs down' feature on the remote control), thus identifying a subscriber's preference for specific programming.

From these ratings, our client's personal television service will suggest similar television programming that the subscriber may enjoy.

2. Viewing Guides -- The Viewing Guides differ from the Programming Guide in that they offer enhanced graphics and formats. The subscriber can access the downloaded programming guides via their PVR and browse them for upcoming television programs. Once the subscriber identifies an upcoming program that he/she wishes to view, the subscriber can record the selected program for later viewing. The viewing guides are also delivered electronically on a nightly basis and stored on the hard drive of the subscriber's PVR.

As part of the personal television service, our client will provide two types of viewing guides:

- An electronic magazine that organizes upcoming television and programming by topic (e.g. comedy, sports, drama and special events).
 - Network Showcases organized by topic and sorted by separate networks (e.g. NBC, CBS, HBO).
3. Programming Content Specifically Created By Our Client -- As part of the subscription to the personal television service, our client will provide several television programs including a weekly half hour preview show. The preview show will offer commentary and viewing suggestions of selected upcoming programming. This service is delivered via broadcast networks during off-peak hours and is recorded on the hard drive of the subscriber's PVR. The subscriber can view or delete this programming from his/her PVR at any time.

Delivery of the of the Programming and Viewing Guides is accomplished via telephone modem connection originated by the subscriber's PVR to our client's Operation Facility located outside of your state. The Operation Facility consists of a series of computer servers that store and transmit our client's information and services to subscribers. The electronic transmissions are also delivered without the transfer of any tangible personal property.

Once our client's Operation Facility verifies that the customer is a valid subscriber, the Program Guide, and Viewing Guides are electronically downloaded onto the hard drive of the subscriber's PVR. In some instances, updates to the PVR's operating system will also be downloaded during this time. In addition to the electronic transmissions, the Program Guide, and Viewing Guides may also be transmitted to the subscriber's PVR via direct-to-home satellite transmission or other electronic media. It is important to note that in all instances the Program Guide, and Viewing Guides are delivered electronically and not by the use of diskettes, CD-Rom or other tangible mediums.

Future Services and Revenue

In the future, our client may provide enhanced services via modem, digital subscriber line (DSL), satellite or other high-speed connection.

In addition, our client may receive additional revenues from the following:

1. Targeted advertising

2. Promotional content programming.
3. Select and purchase products promoted in specialized programming.
4. Delivery of premium programming such as music, games, and motion pictures ordered by a subscriber and delivered and stored on the hard drive of subscriber's PVR. A separately stated fee may be charged for the premium programming.
5. The sale of audience research and measurement.

Billing Procedures

Subscriber's can subscribe to our client's personal television service in the following ways:

1. Customers may contact our client via a toll free number or may subscribe to the service via the World Wide Web.
2. If the subscriber purchases a DSCB, the subscriber can sign up for service by contacting his/her direct-to-home satellite provider using a toll free number or via the World Wide Web. The subscription fee for the personal television service fee may be separately stated on the subscriber's invoice, or included as a component of a premium suite of services.

ISSUES

1. What is your state's sales & use, telecommunications, and/or other gross receipts tax treatment of our client's sale of personal television services to customers located in your state as described in the statement of facts as presented?
2. In some instances our client may offer personal television services in conjunction with other taxable and non-taxable services. Specifically, our client may advertise a suite of services at one price point (i.e. PVR Service and Direct-to-Home Satellite Service), and using their billing system, separately calculate and apply the taxability to each unique component of the suite of services. Billing to the customer may be presented in one line item in the finished invoice. In some instances, customers may only have access to an electronic invoice via the internet. Will this billing approach make any difference to the taxability of our client's service?
3. When personal television services are provided by a direct-to-home satellite provider, are the fees collected from subscribers exempt from local taxation under section 602 of the Federal Telecommunications Act?
4. Are there any other state and/ or local taxes which may apply to our client's services?

ANALYSIS OF ILLINOIS LAW

Overview

Illinois sales and use taxes are contained in four separate acts: the Retailers' Occupation Tax (ROT), the Service Occupation Tax (SOT), the use tax and the service use tax.

The ROT is imposed on persons engaged in the business of selling tangible personal property at retail (35 Illinois Compiled Statutes (ILCS) 120/2). All sales of tangible personal property are presumed subject to the ROT until the contrary is established (35 ILCS 120/7). The tax is measured by the 'gross receipts' received from such sales (86 Illinois Admin. Code 130.101). ROT is not imposed on intangible personal property or real property (86 Illinois Admin. Code 130.120(a),(b)). 'Sale at retail' means any transfer of the ownership of or title to tangible personal property to a purchaser for the purpose of use or consumption for a valuable consideration (35 ILCS 120/1).

The SOT is imposed on persons engaged in the business of making sales of services. Tax is not imposed on the service itself, but on the selling price of tangible personal property transferred incident to the service. Also, SOT is not imposed on the selling price of property that is subject to ROT or use tax (86 Illinois Admin. Code 140.125(f)). A 'sale of service' means any transaction except a retail sale of tangible personal property subject to ROT or a sale or transfer of tangible personal property as an incident to the rendering of service (See, 86 Illinois Admin. Code 140.201(e)). Other exceptions apply but are not relevant to this analysis.

As noted above, the tax on services applies where tangible personal property is transferred. Our client's personal television service does not involve a transfer of tangible personal property under Illinois's sales and use tax laws. Based upon our analysis of Illinois law, administrative guidance and information letters, it is our conclusion that personal television services are non-taxable services in Illinois. Accordingly, the furnishing of personal television services by our client to subscribers in Illinois by the aforementioned methods would not be subject to Illinois sales tax.

However, since personal television services are composed of several unique aspects, including program guides, unique television programming, and in some instances updates to the software operating system of the PVR, we will also address the application of telecommunications and software services to personal television services.

Telecommunications

Telecommunications are specifically subject to the Illinois Telecommunications Excise Tax Act and the Illinois Telecommunications Municipal Infrastructure Maintenance Fee Act (See, 35 ILCS 630/1 - 630/21; 35 ILCS 635/5). 'Telecommunications' includes messages, or information transmitted through use of local, toll and wide area telephone service, channel services, telegraph services, teletypewriter service, computer exchange services; cellular mobile telecommunication service, specialized mobile radio services, paging services, or any other form of mobile and portable one-way or two way communications, or any transmission of messages or information by electronic or similar means (35 ILCS 630/2(c)).

Our client's personal television service does not fall within the purview of taxable 'telecommunications.' A subscriber's PVR however, will initiate a call via telephone modem to our client's servers in order to download the program and viewing guides. Although the definition of telecommunication includes the transmission of information by

telephone, our client's service should be distinguished from telephone transmissions to which the tax is meant to apply because the electronic information and programming guides sent to subscribers is a one-way communication on a non-interactive basis. Private letter ruling, ST 91-0909-PLR supports this contention.

In private letter ruling, ST 91-0909-PLR, (Nov. 21, 1991) an electronic provider of information sent to subscribers one-way through satellite technology and via FM sideband radio was not subject to the Telecommunications Excise Tax. Our client's service is no different. Electronic programming and viewing guides are sent via telephone modem and satellite to subscribers. While the PVR will originate a call to download information, the information is sent one-way and is not interactive (i.e., the subscriber cannot communicate with our client). Accordingly, our client's service is not subject to the Telecommunications Excise Tax.

In private letter ruling, ST 93-0472-PLR, (Sep. 22, 1993), the bureau ruled that a company's one way messaging services were exempt from the telecommunications tax. Specifically, the company argued that the excise tax was meant to apply to those businesses that provide customers a means to transmit or communicate to third parties. In our client's case the focus of its service is not that of providing communications access, but instead, the focus is the provision of a personal television service. The fact that our client's personal television service utilizes telephone lines and satellite to transmit its information should not be determinative that it is providing a telecommunications service (See also, General Information Letter, ST 94-0079-GIL, (Mar. 31, 1994)--interactive entertainment system which utilized television programming and telephone lines did not incur Telecommunications Excise Tax liability on its monthly subscription fees).

The Internal Revenue Service has also addressed taxable telecommunications services in the form of providing two-way communications. In Internal Revenue Letter Ruling 9228016, (Apr. 9, 1992), the Service ruled that utilization of a data network to access the host computers of independent service providers was not a taxable telecommunication service. The Service reasoned that since the network did not permit conversational intercommunication with all other subscribers to the network, the service was not taxable. Similarly, our client's personal television services cannot be used by subscribers to contact other people. Applying the IRS's reasoning then, our client's services should not be subject to the Illinois telecommunications Excise Tax.

Television & Cable Services

There are no specific state sales or use tax provision regarding cable television services and thus, such services are not subject to the Telecommunication Excise Tax (See, General Information Letter, ST 99-0028-GIL (Jan. 8, 1999)).

Our client charges a subscription fee for access to its personal television and information service similar to those of a cable/ satellite service and therefore, such charges are not subject to the Illinois Telecommunications Excise Tax. Under Illinois law persons who provide satellite television services, including basic network channels, premium channels, pay per view movies, sporting events, etc., are not subject to the Telecommunications Excise Tax (See, General Information Letter, ST 95-0220-GIL, (May 25, 1995). Given that our client's services provide one-way audio and video

programming services like those of a cable television/ satellite service, its services likewise should be exempt from any tax.

In General Information Letter, ST 94-0079-GIL, (March 31, 1994) the Department ruled that a taxpayer's interactive information and entertainment system that utilizes television programming and telephone lines does not incur Telecommunications Excise Tax Liability on its monthly subscription fees. The court found that the taxpayer's subscription based interactive entertainment system did not fall within the definition of Telecommunications. Our client's services are analogous to the services in General Information Letter, ST 94-0079- GIL. Our client offers subscribers interactive program guides that allow subscribers to identify and schedule future television recordings and rate programs of interest, thus identifying a subscriber's preference for specific programming. From these ratings, our client's personal television service will suggest similar television programming that the subscriber may enjoy. Since the functional similarities of our client's services are like the non-taxable services described in General Information Letter, ST 94-0079-GIL, personal television service should also not incur Telecommunications Excise Tax liability.

Computer Software

Generally, sales of 'canned' computer software are taxable retail sales; however, if the computer software consists of custom computer programs or software, it is not taxable (86 Illinois Admin. Code 130.1935(c); General Information Letter, ST 94-0397-GIL, (Sep. 23, 1994)). Custom computer programs or software are prepared to the special order of the customer. All other retail sales of computer software are taxable.

Our client provides a nontaxable personal television service and is not in the business of selling software. Any software updates transmitted to a subscriber is transferred only as an incidental part of the provision of personal television services and no tangible personal property is exchanged. The software is not the true object of the transaction and has no value to the purchaser except as part of the personal television services rendered. 'If only services are provided and no tangible personal property is transferred incident to that service, the charges for those services would not be subject to ROT and use tax liability' (See, General Information Letter, ST 94-0397-GIL (Sep. 23, 1994)).

Our client provides its electronic programming and viewing guides to aid the subscriber in identifying and scheduling future recordings. As part of the service the electronic guides are enabled by software and downloaded to the subscribers' PVRs. The programming guides are similar to ones commonly received by cable or a direct-to-home services in that they describe upcoming programs as well as other features. Since programming guides delivered to subscribers have never been classified as software and there is never an exchange of tangible personal property, our client's programming guides and service should be exempt from any ROT or use tax.

Local Taxation Preemption with respect to Direct-To-Home Services

In some instances, our client's personal television service may be transmitted via satellite by a provider of direct-to-home satellite services. In such instances, the direct-to-home satellite service provider will purchase our client's service for resale and sell the service to its customers. It is our belief that when our client's personal television service is resold by a direct-to-home satellite service provider, the fee charged for the

service is exempt from local taxation under Section 602 of the 1996 Federal Telecommunications Act.

Section 602 of the Federal Telecommunications Act of 1996 exempts a provider of direct-to-home satellite service from the collection or remittance, or both, of any tax or fee imposed by any local tax jurisdiction on direct-to-home-satellite service. The intent behind the Telecommunications Act is to remove the tax collecting burden of multiple local taxes from direct-to-home satellite providers and expanding technologies. The statute defines a 'provider of direct-to-home- services' as a person who transmits, broadcasts, sells, or distributes direct-to- home satellite service. The term 'direct-to-home service' is defined as programming transmitted or broadcast by satellite directly to the subscribers' premises without the use of ground receiving or distribution equipment, except at the subscribers' premises or in the uplink process to the satellite.

Our client's personal television service falls within the definition of 'direct-to- home service' since it consists of programming guides and programming that is transmitted by satellite directly to the subscribers' premises. Accordingly, the fees charged to subscribers for personal television services by a direct-to-home service provider are exempt from local taxation, including the local option sales taxes.

Thank you for taking the time to respond to this written request regarding your state's position on our client's personal television service. If you have any questions, please do not hesitate to call us.

DEPARTMENT'S RESPONSE:

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. Television programming or other services in which no tangible personal property is transferred are not subject to Illinois Retailers' Occupation Tax, Use Tax, Service Occupation Tax, and Service Use Tax liability.

Persons who provide satellite television services, including basic network channels, premium channels, pay per view movies, sporting events, etc., are generally not subject to the Telecommunications Excise Tax liability. The "personalized" television services described in your letter are not generally subject to Telecommunications Excise Tax liability.

Your letter requests that we respond to whether your client's billing of both taxable and non-taxable services in a single bill makes any difference as to the taxability of your client's services. Since none of the services referenced in your letter appear to be taxable by the State of Illinois, the billing approach used by your client would not impact the taxability of those transactions. However, if taxable tangible personal property is sold along with services or non-taxable tangible personal property, you have indicated that your client can separately calculate and apply tax to each of the taxable components of the sale. The tax amount incurred would be based on the amounts shown on the retailer's books and records as representing charges for the taxable components of the sale regardless of whether or not the separate charges are shown on the customer's invoice.

Please note that we cannot determine if some of the updates to the PVR's operating systems would be considered computer software or not. Generally, the sale at retail, or transfer, of canned software intended for general or repeated use is taxable. Canned software is considered tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See Section 130.1935(a). Upgrades of canned software are considered to be sales of canned software and the whole agreement is taxable unless the upgrades are separately stated and taxed. See Section 130.1935(b).

A license of software, however, is not considered a taxable retail sale if the license meets all of the criteria set forth in Section 130.1935, including restricting the customer's use and duplication of the software, prohibiting the licensing or transferring of the software to a third party without permission, and requiring the customer to destroy or return all copies of the software to the licensor.

Please refer to the subsection (a)(1)(A-E) of Section 130.1935 for a complete list and description of all the requirements for treatment as an exempt license. If a license agreement meeting all the requirements for treatment as an exempt license is renewed, the renewed license will also be treated as an exempt license if all the criteria set forth in Section 130.1935(a)(1)(A-E) continue to be met in the renewal agreement.

You also inquired about whether the fees for personal television services provided by a direct-to-home satellite provider are exempt from local taxation under Section 602 of the Federal Telecommunications Act. The Department does not administer local telecommunications taxes and, therefore, does not have the authority to provide you with an answer to that question.

You may wish to contact the City of Chicago to confirm that these services described in your letter are not subject to any municipal tax collected directly by that municipality.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk